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An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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UPDATE ON
FOREIGN ACTIVITY IN U.S. EQUITIES

Third-Quarter Activity

Key variables in the foreign investors' decision to invest in U.S. equities are the relative strengths of the U.S. dollar and the U.S. stock market. At times, these two variables may be on divergent courses and the strength of one will outweigh weakness in the other. This was obviously the case in the first half of 1987. A robust stock market drew foreign funds into U.S. equities at a record pace, offsetting considerations of the beleaguered dollar. Although enthusiasm lessened moderately from the first to second quarter, foreign net purchases of $18.4 billion in the first half of 1987 were only a shade below full-year 1986's record $18.7 billion.

The third quarter proved a mixed bag for foreign investment in U.S. equities. The stock market was on a two-month roll through July and August, with the Dow reaching its peak for the year in late August. The dollar held relatively stable through July, actually appreciating against the major currencies. However, although the market went on to glorious highs in August, the dollar resumed a downward course.

Concern over the continuing fall of the dollar and escalating fears of inflationary pressures made for volatile U.S. stock and bond markets in September. The Federal Reserve raised its discount rate to 6% from 5 1/2% early in the month, with the main intent to quell inflationary expectations in the bond markets but with the side effect of aiding the dollar's position in the foreign exchange market. By month-end, although the dollar had firmed, the stock market had given up over 66 points and yields on some long-term bonds were at their highest level in two years.

FOREIGN ACTIVITY IN U.S. EQUITIES
($ Millions)

	Second Quarter 1987		Third Quarter 1987	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$53,854	$3,174	$63,540	$2,103
Belgium-Luxembourg	3,048	130	3,209	123
France	4,133	562	5,366	(17)
Germany	3,786	(138)	4,742	(80)
Netherlands	2,995	476	3,325	367
Switzerland	13,551	451	16,814	30
United Kingdom	24,133	1,527	27,295	1,524
Canada	12,482	62	14,103	189
Latin America & Caribbean	10,956	660	11,932	732
Bermuda	2,520	(36)	2,628	229
Netherlands Antilles	3,344	(2)	3,452	41
Asia	29,254	4,390	44,649	1,669
Hong Kong	3,063	173	3,093	359
Japan	20,348	4,098	34,613	1,923
"Other Asia"*	4,152	(95)	4,743	(1,034)
Total All Countries	**$109,388**	**$8,592**	**$136,760**	**$5,016**

Source: U.S. Treasury
* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

Foreign net purchases of U.S. equities moderated in the third quarter from the record levels of the first two quarters of 1987. Much of the third-quarter slowdown in net acquisition of equities occurred in August, when foreign investors' net purchases plunged to $220 million. It appears that intensified concern over the plight of the dollar overshadowed the rising stock market, as foreign investors' confidence in U.S. equities returned in September when the dollar's slide was temporarily halted. Hence, although not quite on par with the heightened investment level of the first half of the year, foreign net purchases in the third quarter came in at a still-impressive $5.0 billion. For the first three quarters of 1987, foreign investors added a record $23.5 billion of U.S. equities to their portfolios, surpassing 1986's full-year record of $18.7 billion by 25.6%.

Although net purchases dropped in the third quarter, gross transactions rose to a furious clip of $136.8 billion in the third quarter. At $359.2 billion for the first nine months of the year, foreign gross transactions are also some 29% ahead of the 1986 record $277.5 billion. Annualization plus October's preliminary figure would place foreign activity in U.S. equities at over $400.0 billion in 1987.

October...A Surprise

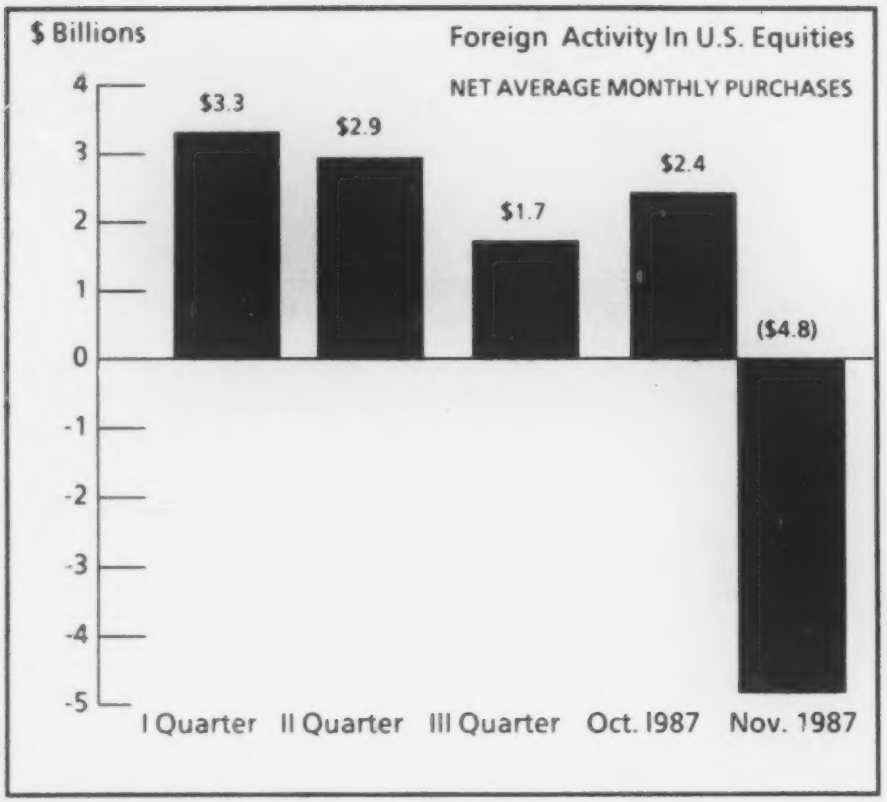
The worries that depressed September's market intensified in early October, cumulating with the market crash on October 19th. Although the market recovered in hectic trading over the remainder of the month, the Dow fell short of the 2,000 mark at October's close. As the Federal Reserve flooded the system with reserves and major banks lowered their prime rate in immediate response to the crash, the dollar once again became vulnerable to downward pressure. By the end of October, major currencies had taken comparably hefty strides ranging from 5% to over 7% vis-a-vis the dollar.

Contrary to speculation indicating net sales of U.S. equities by foreign investors, Treasury's data indicate that foreign investors were not massive net sellers in October. In fact, although caution should be used as the data are very preliminary, foreign investors were still positive on U.S. equity investment in October, making net purchases of $2.4 billion. Along with U.S. investors, foreign investors helped to push U.S. markets to unprecedented volume levels. Preliminary Treasury data puts foreign gross activity at $58.0 billion, compared with a third-quarter average monthly pace of $45.6 billion.

November...A Different Story

However, SIA preliminary and confidential data paints a different picture for November. With policy statements indicating government's emphasis on avoiding a recession at the risk of a lower dollar early in the month, the dollar went reeling through a series of historic lows. Major foreign currencies scored monthly gains of 5% to 7% against the dollar. At the same time, the market waited nervously for word of the budget agreement. Disappointment with the final details of the agreement coupled with the plight of the dollar sent the market on a 77-point tailspin on the last day of the month, leaving the Dow some 160 points down from October's close.

The sagging stock market and a seemingly abandoned dollar prompted foreign investors to shift to a negative investment posture toward U.S. equities. SIA preliminary and confidential data point to significant divestitures of equities by foreign investors in November, with estimates of net sales falling in a range of $4.0 billion to $5.5 billion.



December...The Deciding Factor

Unless November's preliminary number proves only a fluke and foreign investors returned to a positive position on U.S. equity investment in December, the fourth quarter of 1987 could well prove the first one that foreign investors were not positive on U.S. equity investment since the first quarter of 1985.

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